

ALTERNATIVE FORECASTS

DRI has assigned a 60% probability of occurrence to its June 1999 baseline forecast of the U.S. economy. The major features of this forecast include:

- Real GDP growth is 3.9% in 1999, then slows to 2.0% in 2000, rises to 2.1% in 2001, and increases to 2.6% in 2002;
- U.S. nonfarm employment growth is 2.1% this year, 1.6% next year, then averages about 1.0% thereafter;
- the U.S. civilian unemployment rate rises gradually over the forecast period, but remains well below the full-employment level;
- consumer confidence peaks in 1999, then slowly tapers off over the forecast period;
- consumer inflation creeps up from 1.6% in 1998 to 2.6% in 2002;
- the U.S. posts federal budget surpluses in each year of the forecast;
- and the U.S. merchandise trade deficit widens.

While the baseline scenario represents the most likely path for the national economy over the next few years, uncertainties surrounding several key variables mean that other outcomes are also possible. To account for this, DRI prepares alternative forecasts based on different assumptions regarding these key variables. Two of these alternative forecasts, along with their impacts on the Idaho economy, are discussed below.

While it is believed the economy will not suffer a recession over the forecast period, it should be noted that the risk of a recession is high. A review of the probabilities of occurrence for each forecast scenario shows this. The baseline does not include a recession and its probability of occurrence is 60%. However, both of the alternative scenarios do contain recessions and their combined probability of occurrence is 40%. This implies the chances of the economy not suffering a recession over the next few years are just better than even.

PESSIMISTIC SCENARIO

The *Pessimistic-Scenario* has been assigned a 15% probability of occurrence. The near-term risk to the U.S. forecast continues to be a major stock market correction. Because the low savings rate is driven by the high wealth/income ratio, spending may be more sensitive to a drop in the stock market than in the past. A decline in share prices could quickly undermine consumer confidence, and thus consumer spending. This alternative assumes such a correction occurs in 2000. This leads to a recession that same year. The downturn would be exacerbated by the Y2K problem. It is believed that economic activity in 1999 will profit from the expected build up in inventories, as businesses hedge against the so-called “millenium bug.” This will be followed by weaker production in early 2000, as businesses work down excess inventories.

This recession is expected to be relatively mild. Any recession would be met with quick Federal Reserve interest rate cuts. In 2000, it is expected that inflation will still be modest so the Federal Reserve will have more room to manipulate interest rates. This should quickly turn the economy around. The prompt Federal reserve action keeps the reaction mild, with a 1.6% peak-to-trough decline in real GDP. Not surprisingly,

IDAHO ECONOMIC FORECAST
BASELINE AND ALTERNATIVE FORECASTS
JULY 1999

	BASELINE				PESSIMISTIC				LATE RECESSION			
	1999	2000	2001	2002	1999	2000	2001	2002	1999	2000	2001	2002
GDP (BILLIONS)												
Current \$	8,947	9,246	9,605	10,044	8,942	9,026	9,373	9,881	8,965	9,407	9,962	10,213
% Ch	5.1%	3.3%	3.9%	4.6%	5.1%	0.9%	3.8%	5.4%	5.3%	4.9%	5.9%	2.5%
1992 Chain-Weighted	7,845	7,998	8,170	8,384	7,816	7,763	7,943	8,233	7,860	8,097	8,307	8,226
% Ch	3.9%	2.0%	2.1%	2.6%	3.5%	-0.7%	2.3%	3.6%	4.1%	3.0%	2.6%	-1.0%
PERSONAL INCOME - CURR \$												
Idaho (Millions)	27,384	28,703	30,079	31,625	27,368	28,453	29,722	31,298	27,404	28,961	30,833	32,584
% Ch	5.7%	4.8%	4.8%	5.1%	5.7%	4.0%	4.5%	5.3%	5.8%	5.7%	6.5%	5.7%
U.S. (Billions)	7,482	7,806	8,125	8,486	7,473	7,696	7,953	8,341	7,489	7,900	8,383	8,766
% Ch	5.0%	4.3%	4.1%	4.5%	4.9%	3.0%	3.3%	4.9%	5.1%	5.5%	6.1%	4.6%
PERSONAL INCOME - 1992 \$												
Idaho (Millions)	23,962	24,690	25,349	26,071	23,865	24,300	24,886	25,651	23,966	24,746	25,456	25,959
% Ch	4.3%	3.0%	2.7%	2.8%	3.8%	1.8%	2.4%	3.1%	4.3%	3.3%	2.9%	2.0%
U.S. (Billions)	6,547	6,718	6,848	6,997	6,516	6,576	6,660	6,837	6,550	6,753	6,923	6,986
% Ch	3.5%	2.6%	1.9%	2.2%	3.1%	0.9%	1.3%	2.7%	3.6%	3.1%	2.5%	0.9%
TOTAL NONFARM EMPLOYMENT												
Idaho (Thousands)	536.5	549.4	559.7	571.0	535.7	542.3	550.2	563.9	536.6	551.3	563.1	568.2
% Ch	2.9%	2.4%	1.9%	2.0%	2.7%	1.2%	1.5%	2.5%	2.9%	2.7%	2.1%	0.9%
U.S. (Millions)	128.5	130.5	131.9	133.3	128.3	128.2	128.4	130.7	128.6	131.5	133.7	132.8
% Ch	2.1%	1.6%	1.0%	1.1%	2.0%	-0.1%	0.2%	1.8%	2.2%	2.3%	1.7%	-0.7%
GOODS PRODUCING SECTOR												
Idaho (Thousands)	111.8	113.0	114.9	116.9	111.5	109.6	111.4	115.2	112.0	114.5	117.2	114.1
% Ch	0.5%	1.1%	1.6%	1.7%	0.2%	-1.7%	1.6%	3.5%	0.6%	2.3%	2.3%	-2.6%
U.S. (Millions)	25.1	24.7	24.4	24.3	25.1	23.9	23.3	23.6	25.1	25.0	25.1	24.1
% Ch	-0.6%	-1.8%	-1.0%	-0.6%	-0.8%	-4.7%	-2.5%	1.4%	-0.4%	-0.6%	0.2%	-4.0%
SERVICE PRODUCING SECTOR												
Idaho (Thousands)	424.7	436.3	444.8	454.2	424.2	432.7	438.8	448.6	424.7	436.7	445.8	454.0
% Ch	3.5%	2.7%	2.0%	2.1%	3.4%	2.0%	1.4%	2.2%	3.5%	2.8%	2.0%	1.7%
U.S. (Millions)	103.4	105.8	107.4	109.0	103.2	104.3	105.1	107.1	103.4	106.5	108.6	108.8
% Ch	2.8%	2.4%	1.5%	1.5%	2.7%	1.0%	0.8%	1.9%	2.9%	2.9%	2.0%	0.1%
FINANCIAL MARKETS												
Federal Funds Rate	4.7%	4.8%	4.8%	4.8%	4.9%	4.6%	4.3%	4.3%	4.7%	4.8%	5.7%	6.6%
Bank Prime Rate	7.8%	7.7%	7.7%	7.7%	7.2%	7.6%	7.3%	7.3%	7.8%	7.8%	8.8%	9.6%
Mort Rate, New Homes	7.1%	7.3%	7.1%	6.8%	7.2%	7.6%	7.2%	7.1%	7.1%	7.2%	7.2%	8.1%
INFLATION												
GDP Price Deflator	1.2%	1.4%	1.7%	1.9%	1.5%	1.7%	1.5%	1.7%	1.2%	1.9%	3.2%	3.5%
Personal Cons Deflator	1.4%	1.7%	2.1%	2.2%	1.8%	2.1%	2.0%	2.2%	1.4%	2.3%	3.5%	3.6%
Consumer Price Index	2.1%	2.3%	2.5%	2.5%	2.4%	2.7%	2.3%	2.4%	2.1%	2.9%	4.0%	4.0%

Forecast Begins the FIRST Quarter of 1999

the interest-rate-sensitive sectors of the economy recover the quickest. By 2002, the stock market is expected to have made up the entire 15.6% value drop it experienced in 2000.

Like its national counterpart, Idaho's economy is most affected in 2000 and 2001. Idaho nonfarm employment manages to grow just 1.2% in 2000 and 1.5% in 2001. In the baseline case employment was expected to rise 2.4% in 2000 and 1.9% in 2001. However, it does come back strongly in 2002. In that year nonfarm employment should increase 2.5%, which is much stronger than the baseline's 2.0% pace. Despite this surge, there are about 7,000 less jobs in 2002 under this forecast than under the baseline case. Idaho real personal income displays a similar growth pattern. That is, it grows much slower in 2000 compared to the baseline, picks up speed in 2001, and grows faster than the baseline in 2002. Like employment, however, it too is lower than its baseline counterpart in 2002.

LATE-RECESSION SCENARIO

The *Late-Recession Scenario* has also been assigned a higher probability than the *Pessimistic Scenario* (25% versus 15%). This is because the *Late-Recession Scenario* is a typical end-of-expansion recession, and it seems more likely to finish the current expansion than an early recession. In this scenario, the U.S. economy grows stronger in 1999-2000 than in the baseline. As a result, the unemployment rate stays low, which keeps consumer confidence elevated. In addition, it is assumed that a federal tax cut is enacted. The U.S. stock market keeps climbing. Consumer spending booms under these conditions, but there is a high cost associated with the good times. Tighter labor markets push inflation higher. More importantly, commodity prices, including oil, rebound as foreign economies recover and the U.S. economy surges.

The Federal Reserve is initially hesitant to "take the punchbowl away from the party." But as inflationary pressures bubble to the surface, the Federal Reserve can no longer postpone the inevitable. It raises interest rates sharply beginning in late 2000, with the federal funds rate reaching 7.0% in early 2002. In addition, it assumed that a stock market correction hits during this period, which takes a toll on consumer confidence. The combination of higher interest rates and damaged consumer confidence hurts consumer spending, especially for large-ticket items. The economy falls into a recession in 2001. The Federal Reserve would like to end the recession quickly, but finds its options limited. The high inflation prevents the nation's central bank from aggressively lowering rates. As a result, this recession is deeper and longer than the one depicted in the *Pessimistic Scenario*.

Also in this scenario, Idaho's economy actually out performs its baseline counterpart in both this year and next. Idaho nonfarm employment rises 2.7% in 2000 and 2.1% in 2001. In comparison it was expected to increase 2.4% in 2000 and 1.9% in 2001 in the baseline case. Idaho real personal income growth is 3.3% this year and 2.9% next year, which is greater than in the baseline. However, it is not expected to maintain these margins through the forecast period. The economic slowdown anticipated in this scenario causes both nonfarm employment and real income to grow slower than in the baseline in 2002.